

Caught in the Middle: Trade War's Impact on Consumers and Investors

The escalating trade war with China, Canada, and other countries is already affecting targeted industries and products. History suggests that consumers and investors will ultimately pay the price.

Originally affecting just 18 products, the trade war now involves about 10,000, as trading partners retaliate against U.S.-imposed tariffs.

The trade war is on. In January, the Trump Administration announced tariffs on washing machines and solar panels. In March, it added steel and aluminum. In April and June, it announced tariffs on \$50 billion of in goods from China, and in July, proposed increasing that number to \$200 billion. Predictably, trading partners have retaliated, announcing tariffs of their own on a variety of imports from the U.S.

Thus far, U.S.-imposed tariffs have been targeted primarily at non-consumer goods. But the list keeps growing, and retaliatory tariffs include an increasing number of consumer and agricultural products. As of mid-July, the war had escalated to affect about 10,000 products, up from just 18 in January.¹ And as the battle progresses, the list is likely to grow even larger.

In fact, the world appears to be closer to a full-scale trade war than at any time since the 1930s, when Congress, in an effort to protect U.S. businesses and farmers, passed the infamous Smoot-Hawley Tariff Act, which raised tariffs on more than 20,000 products. The Act drew immediate retaliation and counter-retaliation, bringing about a 61% drop in U.S. exports from 1929 to 1933 and exacerbating the Great Depression.

Winners and Losers

Economists generally agree that, in the aggregate, trade wars are not easy to win. Tariffs prompt retaliation, raise costs, stifle competition, and create barriers to the flow of goods and services. Protected industries may benefit -- for a time at least. But today's globalized supply chains and multinational operations permit some companies to work around the barriers by channeling exports through exempt countries. Tariffs also can have unexpected consequences. For instance, Harley Davidson, the iconic American motorcycle manufacturer, announced in June that it would shift some production overseas to avoid stiff retaliatory tariffs imposed by the European Union in response to U.S. trade measures. And Whirlpool, whose washing machine sales stand to benefit from U.S. imposed tariffs on washer imports, has seen these benefits offset by higher production costs as a result of new tariffs on imported steel and aluminum.

In fact, tariffs tend to be most successful in cases where one trading partner is

significantly larger than the other, effectively giving it greater clout. The current battle involves both big and small players and it is unclear who will win or lose. The biggest players, the U.S. and China, have both indicated that they are not about to back down. In the meantime, it is consumers and investors who are most likely to feel the pain.

Who Pays

For consumers, the most immediate effect of a trade war is higher prices on affected goods. Prices have already risen on certain products, and more increases are likely to follow. Here is a current list of goods that are likely to cost more as a result of the trade war.²

- Washing machines
- Solar panels
- Cars
- Home appliances
- Cell phones
- Computers
- Toys

But the list does not end here. Many products that remain tariff free may be indirectly affected because they use materials to which tariffs apply. Companies are likely to pass on those higher costs to consumers.

For investors, trade wars mean volatility. Stock markets have already experienced wide swings as a result of trade war fears. Following the announcement of proposed tariffs on Chinese goods in early April, the Dow Jones Industrial Average tumbled 2.3% in one day. Trade-sensitive industrial stocks have been especially affected, as investors fret about the effect of tariffs on earnings. Such volatility is likely to continue as the effects of the trade war gradually emerge.

Investors who wish to cushion their portfolios against the risk of a full-scale trade war may want to evaluate their exposure to export-oriented companies or industries and ensure adequate diversification, including to U.S. sectors that stand to benefit directly from the tariffs. Be sure to work with your financial advisor, who can help align your portfolio with your specific needs.

¹Source: New York Times, July 11, 2018.

²Source Money, *All the Products That Will Cost You More Because of Trump's Trade War*, June 26, 2018.